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INTERZONAL TRADE: A BRIDGE BETWEEN THE BLOC
AND THE COMMON MARKET?



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INTERZONAL TRADE: A BRIDGE BETWEEN THE BLOC
AND THE COMMON MARKET?

I. Introduction

East German requests for large-scale credits from West Germany -- which reportedly began as early as February but remained a secret closely guarded by both parties until a "press leak" occurred late in May -- coupled with current East German proposals for a sharply increased turnover in interzonal trade, appear to be a sharp departure from the "invulnerability" campaign of recent years. The revised East German attitude also is somewhat difficult to reconcile with recent and widely publicized moves to integrate more closely the East German and Soviet economies. East German attempts to insure over a long-term period the artificially high level of trade presently proposed may well constitute an attempt by the Soviet Bloc to establish through the interzonal trade channel a means of free access to the Common Market. The unique interzonal relationship which dictates that trade between East and West Germany is internal trade and therefore not subject to the restrictions of international commerce provides East Germany -- and indirectly the rest of the Bloc -- at least a temporary legal opportunity to assume a decidedly "preferred" position in relation to the Common Market. From the standpoint of overall Soviet policy, however, perhaps another important motive for the East German proposals can be found in their potentially divisive effect on Western unity itself.

II. Trade Proposals

West German official sources have now confirmed earlier press leaks indicating that the East German government had utilized interzonal trade channels to request long-term credits totaling approximately US \$780 million. Since February of this year, Heinz Behrendt, chief East German representative on the interzonal trade commission, reportedly has made three separate proposals. In his first approach to the West German interzonal trade negotiator Leopold on 13 February, Behrendt requested a commodity credit amounting to 2.55 billion Deutschmarks (DM) (\$637.5 million) to cover East German purchases of 3 million tons of coal and coke annually over the next 10 years, with repayment to be effected through shipments of crude petroleum and lignite

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during 1967-83. In April a request was made for 500 million DM (\$125 million) in credit to cover East German purchases of machinery and industrial goods to be delivered during 1962-64, with repayment through East German deliveries of unspecified products during 1965-72. Finally, in a third approach also in April 1962 the East Germans requested a further credit of 65 million DM (\$16.2 million) for agricultural, pharmaceutical, and textile goods to be repaid through existing interzonal trade channels. 1/

East German statements in the party-controlled press have attempted to depict the proposed commodity exchange as "not unusual in inter-German trade" and, further, to distort the suggested coal deal as one of East German aid to West Germany currently necessary "in view of the marketing crisis in the West German mining industry and its consequences for the mineworkers." 2/ Nevertheless, the fact that the East German government has not withdrawn these requests in spite of the embarrassing publicity attending Western press coverage in recent weeks indicates the seriousness of its desire for West German credits at this time.

The East German government reportedly also has proposed a sharp increase in the level of interzonal trade presumably in the "barter" accounts that normally control the commodity exchange between the two zones. 3/ At a meeting on 22 May of representatives of various East German trading organizations and West Berlin businessmen involved in interzonal trade, Behrendt reportedly disclosed that he had proposed to Leopold that trade under the interzonal agreement be "increased threefold to about 3 billion marks per year". 4/ The current level of trade approximates 1 billion DM each way, and available sources do not make clear whether Behrendt actually was referring to an increase to three times the present turnover (that is, to 6 billion DM) or to a total turnover of 3 billion DM (that is, 50 percent above the current level of trade). In any event, either interpretation results in a level of trade that is at least seemingly incompatible with East Germany's avowed goal of decreased dependence on imports from West Germany.

III. Potential for Soviet Bloc Economic Penetration

It is possible that at least a partial explanation of East German overtures to West Germany can be found in increasing Bloc fears concerning the effects of the rapidly developing Common Market on the ability of the Bloc to compete in Western markets. The attention devoted to this

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subject both by the press and government officials in the Bloc indicates a growing concern about the economic consequences attending the successful development of European regional integration. Although the political implications of Western unity present perhaps a more serious challenge to Soviet aims, there is little question that the economic impact of such unity, particularly on the European Satellites, is viewed with some importance by the Bloc. The unique position of interzonal trade could provide East Germany -- and indirectly other Bloc countries -- with a very useful avenue to the Common Market.

A protocol (see the appendix) to the Rome treaty establishing the European Economic Community recognizes the West German position that interzonal trade is part of internal German trade and therefore requires no amendment by virtue of West Germany's adherence to the rules of membership in the Common Market. Although the two remaining articles in the protocol provide that each Market member will insure that implementation of its trade agreements with East Germany will not conflict with "the principles of the Common Market" and may take "suitable measures" against difficulties arising for it from trade between another member and East Germany, there appears to be no specific regulation or control to insure either domestic consumption of West German imports or domestic origin of West German exports in interzonal trade. In the absence of controls between East and West Germany and between West Germany and the rest of the Common Market, interzonal trade, at least technically, affords East German commerce free access to the area within the "tariff wall" -- a far more advantageous position than that enjoyed by any Western nonmember nation.

In the absence of protective measures by other members of the Common Market, East Germany thus could provide the rest of the Bloc with a vehicle unencumbered by tariffs or quotas, to be utilized as needed for the purchase of imports required by the Bloc and the disposal of Bloc export products in the area of the Common Market. Bloc planning along these lines already appears to have been initiated.

In a speech to West Berlin businessmen on 22 May, for example, Behrendt voiced the hope that "new fields of trade will be opened up which heretofore have not appeared in interzonal trade". 5/ Behrendt's references to East German ability to support a substantially

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higher level of interzonal trade through the introduction into its export program of new lines of products and expansion of the volume of commodities currently exported were interpreted by Western observers as an indication of an increase in supplies from the Bloc. East Germany reportedly plans to import for domestic consumption goods similar to those shipped in interzonal trade, thereby enabling it to export a larger portion of the domestic production of these commodities and, in addition, to enlarge the volume of its exports to West Germany through shipments of products actually imported from other Bloc countries. 6/

A main function of the recently established East German trading firm Zentralcommerz quite probably is to circumvent Common Market restrictions for the Bloc through its interzonal trade channel. In addition to freeing as much of East German production as possible for export to West Germany by increased imports from the Bloc, Zentralcommerz reportedly will attempt to market Bloc products through interzonal trade, declaring them to be of East German origin. In brokering Bloc products through interzonal trade, particularly of goods such as agricultural products whose origin cannot be established readily, Zentralcommerz would share with the supplier country any gains occurring as a result of avoiding the Market tariffs. 7/

The import needs of other Bloc countries also appear to be reflected in the East German applications for credits from West Germany. For example, although East German requirements for hard coal are undoubtedly greater than current availabilities, it is difficult to justify the absorption into the East German economy of 3 million additional tons annually. It is unlikely that the hard coal requested is destined mainly for the East German railroads in view of the fact that there has been little indication of the large-scale locomotive conversion required in the substitution of large amounts of hard coal for the less efficient but plentiful brown coal that is now widely used. From the standpoint of over-all Bloc requirements and normal East German imports from the West, it would appear more likely that the hard coal requested would be of a coking variety. East German requirements for other types of hard coal could be readily filled from sources within the Bloc (for example, Poland), but there is substantial evidence of an increasingly serious shortage of high-quality

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coking coal throughout the Bloc. Czechoslovakia -- normally the only Bloc country with a surplus of high-quality coking coal -- as well as Poland, for the first time has been procuring additional supplies in the Free World. If, in fact, East Germany is requesting credit facilities for imports of coking coal in such large quantities, it is evident that a substantial portion would be destined for other Bloc consumers, inasmuch as East Germany would not require more than an estimated 250,000 to 300,000 tons annually to run its domestic coke oven facilities at capacity. 8/

Repayment of this credit in crude petroleum and lignite, as suggested by the East Germans, undoubtedly would entail a sharp increase in the flow of Soviet crude into West Germany, inasmuch as the West German economy would be unable to absorb lignite in any amount substantially larger than that already imported in interzonal trade and East German domestic production of crude petroleum is negligible. Although current planning among the Common Market countries does not envisage a levying of tariffs or quotas on the import of crude petroleum, the suggested repayment terms could afford Soviet crude a partial insurance against future revision of this policy. In any event, the major international oil companies have been attempting to protect their interests against the incursions of cheap Soviet crude and, in the case of West Germany in particular, a desire to protect the domestic coal industry, which is already experiencing serious difficulties from its inability to compete with Western petroleum, has further hindered direct Soviet sales. 9/

Current trade agreements with the USSR establish a quota on petroleum imports amounting to about 5 percent of West German petroleum requirements. 10/ Although West German imports of Soviet crude increased from 1 million tons (\$14 million in value terms) in 1960 to about 1.6 million tons in 1961, 11/ the amount of Soviet crude penetrating the West German market continues to be far below the level that would be required to repay the \$637.5 million credit for hard coal. On the assumption that most of the indebtedness would be repaid in crude petroleum during the suggested period of repayment (1967-83), perhaps as much as \$35 million to \$40 million annually in Soviet petroleum could move into West Germany through interzonal trade.

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Even were the means found to limit the flow of commodities in interzonal trade within the confines of the German area, East Germany would still occupy a highly preferred position in relation to the Common Market. West Germany now supplies 74 percent of East German imports from the Common Market and buys 80 percent of its exports from this area. If desired, it is apparent that the heterogeneous productive capacity of West Germany could fill virtually all of East Germany's requirements for imports from the Industrial West, provided that suitable East German exports or other means of financing could be arranged.

IV. Political Implications

East Germany, with the approval of the USSR -- and very possibly at Soviet instigation -- can be expected, therefore, to exploit to the fullest extent the advantages deriving from its unique relationship with West Germany, both for the purpose of insuring its own preferred position in relation to the Common Market and in order to ease as much as possible the difficulties arising for other Bloc countries as a result of West European integration. These economic factors alone would be sufficient reason for East German proposals to enlarge the format of interzonal trade. From the standpoint of over-all Soviet policy, however, perhaps another important motive for these actions can be found in their potential to exert a divisive influence on Western unity. At a time when other Market members -- and prospective members -- are being forced to sacrifice important and longstanding relationships, the USSR may consider it extremely beneficial to its purposes to remind them of continuing West German obligations and to illustrate that these obligations have for the Common Market implications considerably greater than those originally contemplated.

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APPENDIX

PROTOCOL RELATING TO GERMAN INTERNAL TRADE
AND CONNECTED PROBLEMS

THE HIGH CONTRACTING PARTIES,

CONSIDERING the conditions at present existing by
reason of the division of Germany,

HAVE AGREED upon the following provisions which shall
be annexed to this Treaty:

1. Since exchanges between the German territories subject to the Basic Law for the Federal Republic of Germany and the German territories in which the Basic Law does not apply are part of German internal trade, the application of this Treaty requires no amendment of the existing system of such trade within Germany.

2. Each Member State shall inform the other Member States and the Commission of any agreements affecting exchanges with the German territories in which the Basic Law for the Federal Republic of Germany does not apply, as well as of the provisions for their implementation. Each Member State shall insure that such implementation shall not conflict with the principles of the Common Market and shall, in particular, take appropriate measures to avoid any prejudice which might be caused to the economies of the other Member States.

3. Each Member State may take suitable measures to prevent any difficulties which might arise for it from trade between another Member State and the German territories in which the Basic Law for the Federal Republic of Germany does not apply.

Done at Rome, on the twenty-fifth day of March in the
year one thousand nine hundred and fifty-seven.

P. H. Spaak.
Adenauer.
Pineau.
Antonio Segni.
Bech.
J. Luns.

J. Ch. Snoy et d'Oppuers.
Hallstein.
M. Faure.
Gaetano Martino.
Lambert Schaus.
J. Linthorst Homan.

East German Trade with the Common Market (EEC) a/
1959-61

Million US \$

	East Germany						Total Turnover		
	Exports			Imports					
	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>
West Germany	212.53	267.2	234.0	256.8	228.4	216.7	469.1	495.7	450.7
France	7.1	7.1	8.4	8.3	14.1	21.6	15.4	21.2	30.0
Italy	5.9	14.5	17.6	6.2	6.8	16.1	12.2	21.4	33.6
Netherlands	15.5	18.7	18.7	11.4	15.5	27.5	26.9	34.2	46.3
Belgium- Luxembourg	12.9	15.6	14.3	8.4	13.1	12.0	21.3	28.7	26.3
Total	<u>253.7</u>	<u>323.1</u>	<u>293.0</u>	<u>291.1</u>	<u>277.9</u>	<u>293.9</u>	<u>544.9</u>	<u>601.2</u>	<u>586.9</u>

a. 12/. Because of rounding, components may not add to the totals shown.

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